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IN THE

Supreme Court of the United States

OCTOBER TERM 1968

No. 1142

In the Matter of

THE NEW YORK, NEW HAVEN AND HARTFORD RAILROAD COMPANY,

Debtor

ABEX CORP., ARTHUR ANDERSEN & COMPANY, BETHLEHEM STEEL CORPORATION, *et al.*,

Petitioners,

—against—

TRUSTEES OF THE PROPERTY OF THE NEW YORK, NEW HAVEN AND HARTFORD RAILROAD COMPANY, *et. al.*,

Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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March 10, 1969

TABLE OF CONTENTS

	PAGE
OPINIONS BELOW	2
JURISDICTION	2
QUESTIONS PRESENTED	2
STATEMENT OF THE CASE	3
DECISION BELOW	5
REASONS FOR GRANTING THE WRIT	6
ARGUMENT	6
I. This Case Involves Important Questions of Federal Law Which Have Not Been, But Should Be, Settled By This Court	6
A. This Case Involves an Important Question of Federal Law Relating to the National Transportation Policy	7
B. This Case Involves an Important Question of Federal Law Under the Bankruptcy Act	12
II. The Decision of the Court Below In This Case Is In Conflict With the Decision of Another Court of Appeals on the Same Matter	16
CONCLUSION	17

Cases Cited

Girouard v. *U. S.*, 328 U. S. 61 (1946)	11
Gregg v. *Metropolitan Trust Co.*, 197 U. S. 183 (1905)	6, 7
In re New York, New Haven & Hartford RR, 278 F. Supp. 592 (D. Conn. 1967)	2

PAGE

Johnson v. *United States*, 163 F. 30 (1st Cir. 1908) .. 10

Meyers v. *Jay Street Connecting R.R.*, 259 F. 2d 532 (2d Cir. 1958) 10

Meyers v. *Jay Street Connecting R. R.*, 288 F. 2d 356 (2d Cir. 1961) 10

New York, N. H. & H. R. R. Loan Guaranty, 312 ICC 300 (1960) 11

New York, N. H. & H. R. R. Loan Guaranty, 312 ICC 471 (1961) 11

Passenger Fares, New York, N. H. & H. R. R., 313 ICC 411 (1961) 11

Pennsylvania R. R.—Merger—New York Central R. R., 331 ICC 643 (1967) 15

Southern Ry. v. *Flournoy*, 301 F. 2d 847 (4th Cir. 1962) 6, 16

United States v. *Hutcheson*, 312 U. S. 219 (1941) ... 10

Statutes and Regulations Cited

Act of March 2, 1893, c. 196, 27 Stat. 531 7

Act of April 1, 1896, c. 87, 29 Stat. 85 7

Act of March 3, 1901, c. 866, 31 Stat. 1446 7

Act of March 2, 1903, c. 976, 32 Stat. 943 7

Act of June 29, 1906, c. 3591, 34 Stat. 584 (Hepburn Act) 9

Act of May 30, 1908, c. 225, 35 Stat. 476 (Ash Pan Act) 8

Act of April 14, 1910, c. 160, 36 Stat. 298 8

Act of May 6, 1910, c. 208, 36 Stat. 350 8

Act of February 7, 1911, c. 103, 36 Stat. 1913 (Locomotive Inspection Act of 1911) 8

PAGE

Act of March 4, 1915, c. 169, 38 Stat. 1192 8

Act of February 28, 1920, c. 91, 41 Stat. 474 (Transportation Act of 1920) 8

BANKRUPTCY ACT:

Section 60, 11 U. S. C. § 96 (1964) 2
Sections 60(a), (b), 11 U. S. C. §§ 96(a), (b) (1964) 13
Section 67, 11 U. S. C. § 107 (1964) 2, 13, 14
Section 67(d)(2), 11 U. S. C. § 107(d)(2) (1964) 13
Section 70, 11 U. S. C. § 110 (1964) 2, 13
Section 70(e), 11 U. S. C. § 110(e) (1964) 14
Section 77, 11 U.S.C. § 205 (1964) .....*passim*
Section 77(b), 11 U. S. C. § 205(b) (1964)...2, 3, 12
Section 77(c)(2), 11 U. S. C. § 205(c)(2) (1967) 12, 13
Section 77(c)(3), 11 U. S. C. § 205(c)(3) (1964) 9
Section 77(e), 11 U. S. C. § 205(e) (1964).....2, 15
Section 77(*l*), 11 U. S. C. § 205(*l*) (1964) ...12, 13
Section 77(o), 11 U. S. C. § 205(o) (1964) 9

INTERSTATE COMMERCE ACT:

Part I, 49 U. S. C. §§ 1-300 (1964) 3
Section 1(18), 49 U. S. C. § 1(18) (1964) 9
Section 1(20), 49 U. S. C. § 1(20) (1964) 9

Interstate Commerce Act as amended to 1905, 24 Stat. Stat. 379 (1887), 25 Stat. 855 (1889), 26 Stat. 743 (1891), 28 Stat. 643 (1895), 32 Stat. 847 (1903) .. 7

34 Stat. 838 (Block Signal Resolution, Joint Resolution No. 46 of June 30, 1906) 7
28 U. S. C. § 1254(1) (1966) 2
49 CFR, Pts. 91, 125, 131-136 8

Other Authorities Cited

PAGE

Landis, *Statutes and Sources of Law,* HARVARD LEGAL ESSAYS 213 (1934) 11

Moody's Transportation Manual, 1968 6

TPR-10 (Trustees' Plan of Reorganization as presented in Hearings before ICC Hearing Examiner Present on November 29 and 30, 1967), New York, N. H. and H. R. R. Reorganization, Finance Docket No. 21669 5

IN THE

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ABEX CORP., ARTHUR ANDERSEN & COMPANY, BETHLEHEM STEEL CORPORATION, *et al.*,

Petitioners,

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TRUSTEES OF THE PROPERTY OF THE NEW YORK, NEW HAVEN AND HARTFORD RAILROAD COMPANY, *et al.*,

Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Petitioners pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Second Circuit, entered December 9, 1968, which affirmed an order of the United States District Court for the District of Connecticut, entered August 28, 1967.

OPINIONS BELOW

The opinion of the Court of Appeals has not been officially reported but is set out in the Appendix to this Petition at page 1A. The opinion of the United States District Court is reported at 278 F. Supp. 592 (1967) and set out in the Appendix at page 9A. The judgments of the Court of Appeals and the District Court are set out in the Appendix at pages 7A and 33A, respectively.

JURISDICTION

The judgment of the Court of Appeals was entered December 9, 1968, and the jurisdiction of this Court is invoked under 28 U. S. C. § 1254(1) (1966).

QUESTIONS PRESENTED

1. Do the necessary implications of the Interstate Commerce Act and the Federal Safety Appliance Acts require that priority status be accorded to claims for necessary operating materials, supplies and services furnished on credit to a railroad carrier within six months prior to its petition for reorganization under Section 77 of the Bankruptcy Act even though satisfaction of that priority diminishes the recoveries of the railroad's mortgage bondholders?

2. Do the lien standards of Sections 60, 67 and 70 of the Bankruptcy Act together with the provisions of Section 77(b) of that Act and the "fair and equitable" standard of Section 77(e) of that Act mandate recognition in a plan of reorganization of priority, albeit unsecured, creditors to the extent of assets coming into the hands of Section 77 trustees of a railroad free of any valid lien even if such assets are applied by such trustees to the continued operation of such railroad?

STATEMENT OF THE CASE

In the six months preceding July 7, 1961, Petitioners extended credit to The New York, New Haven and Hartford Railroad Company (the "debtor") for necessary operating materials, supplies and services. Having been unable to meet obligations due July 1, 1961, on its funded indebtedness, the debtor, a common carrier by rail within the meaning of Part I of the Interstate Commerce Act, 49 U. S. C. §§ 1-300 (1964) (the "Interstate Commerce Act"), on July 7, 1961, filed a voluntary petition for reorganization under Section 77 of the Bankruptcy Act, 11 U. S. C. § 205 (1964) (the "Bankruptcy Act") which was approved on that date.

On January 9, 1962, the Section 77 trustees of the debtor ("Statutory Trustees") invited creditors who believed their claims "to be entitled to the priority accorded to creditors of a railroad company in reorganization who have furnished within the six-month period immediately preceding the beginning of the reorganization the labor, supplies, materials or repairs, necessary for the current operation of the railroad", to file proofs of such entitlement. (The priority referred to derives from the so-called "six-months rule" recognized in Federal equity receiverships for almost a century and incorporated in Section 77 by the provisions of the last paragraph of Section 77(b).) On July 14, 1965, the Statutory Trustees reported that six-months claims in the amount of $4,670,300.91 had been filed.

On November 18, 1965, the Statutory Trustees filed with the District Court a Memorandum urging that six-months priorities not be recognized in these proceedings because (a) all the assets of the debtor were subject to the liens of the debtor's mortgage bondholders, (b) absent unliened assets, recognition of priority of the six-months

claims is prohibited except to the extent they can be satisfied from surplus operating revenues (disregarding diversions of such revenues for the benefit of bondholders) and (c) no such surplus exists in these proceedings. The trustees under the debtor's several mortgage bond indentures (the "Mortgage Trustees") thereafter aligned themselves with these positions of the Statutory Trustees.

Petitioners responded that (i) the pervasive national policy mandating safe and uninterrupted railroad service without regard to its profitability requires that the claims of six-months creditors be satisfied regardless of the presence or absence of any special "fund", (ii) the liens of the debtor's mortgages on its current assets were void under the Bankruptcy Act and the six-months creditors, with other priority claimants, were entitled to priority of payment from those free assets or, if such free assets have been consumed in operation of the debtor in reorganization, from mortgaged assets and (iii) on a "cash accounting" basis, the debtor had generated surplus revenues sufficient to permit recognition of six-months priorities.

The record was developed to show that at the time of the commencement of the reorganization proceedings the debtor had current assets of about $23,380,000 and current liabilities (including Petitioners' six-months claims) of about $59,690,000, though the current assets were used either to pay selected preorganization claims included in the current liabilities (which payments in the judgment of the Statutory Trustees were necessary to permit the continued operation of the railroad) or were expended or consumed in the operation of the railroad during the early months of the reorganization proceedings. The record also shows that the only possible property right of the mortgage bondholders in those current assets derived from the so-called "springing lien" provisions of their mortgage indentures.

The Statutory Trustees have submitted a Plan of Reorganization which makes alternative provision for the six-months claims, granting priority status for claims, including six-months claims, found to be entitled to be treated as "administration claims" while making no payment on general unsecured claims, including six-months claims, not found to be entitled to priority, *see* TPR-10, Trustees' Plan of Reorganization as presented in hearings before ICC Hearing Examiner Present on November 29 and 30, 1967, in New York, N. H. and H. R. R. Reorganization, Finance Docket No. 21669.

DECISION BELOW

The Court of Appeals considered the question presented to be

> "whether the New Haven had at any relevant time a fund consisting in effect of current assets which equitable considerations require to be paid to the six months creditors but which by reason of the original mortgage security or the so-called springing liens has become an asset available to the bondholders."

It answered that question in the negative, affirming the judgment of the District Court. The District Court had similarly answered the quoted question but also considered the questions presented by this Petition and set forth above. The District Court reasoned that policy considerations dictated that vendors of necessary materials, supplies and services necessary for railroad operations should be deterred from extending trade credit to financially shaky railroads and that *that* policy was best served by adhering to the surplus "fund" requirement postulated by the Statutory Trustees and the Mortgage Trustees. (App. 29A) The

District Court also found that the springing liens of the debtor mortgages on its current assets were merely displaced *pro tanto* to permit satisfaction of six-months priorities to the extent to which (as the District Court found not the case here) those assets were not required to be expended or consumed to permit the continued operation of the railroad. (App. 20A, 22A).

REASONS FOR GRANTING THE WRIT

1. The Court of Appeals has decided important questions of federal law which have not been, but should be, settled by this Court. The questions of law presented are important in as much as The Central Railroad Company of New Jersey is now in reorganization under Section 77 and, in 1967, eleven Class I railroads showed a deficit in their Net Railway Operating Income accounts, Moody's Transportation Manual, 1968

2. The decision of the Court of Appeals below is in conflict with the opinion of the Court of Appeals for the Fourth Circuit in *Southern Ry.* v. *Flournoy,* 301 F. 2d 847 (1962).

ARGUMENT

I. This Case Involves Important Questions of Federal Law Which Have Not Been, But Should Be Settled By This Court.

In the latter part of the last century and the very early part of this century, this Court addressed itself frequently to the six-months rule. Its last holding on the subject, *Gregg* v. *Metropolitan Trust Co.,* 197 U. S. 183 (1905), was to the effect that six-months priorities may only be recognized to the extent of any surplus "fund" which might arise from

railway operating profits (or diversion thereof for the benefit of the bondholders). Even that holding was subject to a dissent which took the position that if supplies sold to a railroad on credit were essential to the continued operation of the railroad in the public interest, the six-month priorities should be recognized regardless of the existence or non-existence of any fund, 197 U. S. 183, 190. Important post-*Gregg* Federal legislation articulates national transportation policy and national policies relating to railroad reorganizations which raise substantial questions whether six-months priorities should be recognized in Section 77 proceedings regardless of the profitability of the debtor's operations.

A. This Case Involves an Important Question of Federal Law Relating to the National Transportation Policy.

When the Supreme Court decided the *Gregg* case in 1905, national transportation policy embraced little more than the prohibition of excessive and discriminatory charges* and an embryonic concern with the safety of rail operations.** The year following the *Gregg* decision Congress embarked upon what amounted to a major expansion of the federal concern for the safe operation of railroads. The Block Signal Resolution, Joint Resolution No. 46 of June 30, 1906, 34 Stat. 838, directed the Interstate Commerce Commission (the "ICC" or the "Commission") to investigate block signal and automatic control systems for trains. Specific safety requirements for locomotives were

*See original *Interstate Commerce Act* as amended prior to 1905, 24 Stat. 379 (1887), 25 Stat. 855 (1889), 26 Stat. 743 (1891), 28 Stat. 643 (1895), 32 Stat. 847 (1903).

***See* Act of March 2, 1893, c. 196, 27 Stat. 531, Act of March 2, 1903, c. 976, 32 Stat. 943, Act of April 1, 1896, c. 87, 29 Stat. 85, and Act of March 3, 1901, c. 866, 31 Stat. 1446.

legislated by the Ash Pan Act, Act of May 30, 1908, c. 225, 35 Stat. 476. The Act of April 14, 1910, c. 160, 36 Stat. 298, required cars to be equipped with a list of safety "hardware" ranging from sill steps to ladders and ladder grab irons and vested in the ICC the power to designate binding equipment standards and to enforce all requirements for the safe operation of railways. Concurrently, the Act of May 6, 1910, c. 208, 36 Stat. 350, substantially enlarged and strengthened accident reporting requirements and made specific provision for the inclusion in reports of data bearing on equipment and maintenance failures. The Locomotive Inspection Act of 1911, Act of February 17, 1911, c. 103, 36 Stat. 913 (expanded by the Act of March 4, 1915, c. 169, 38 Stat. 1192), required regular maintenance and periodic inspection of locomotives by rail carriers and provided for a permanent staff of inspectors under ICC supervision. The Transportation Act of 1920, Act of February 28, 1920, c. 91, 41 Stat. 474, consolidated the Commission's rule-making and enforcement functions and, for the first time, vested in the Commission authority to *order* a railroad to install automatic braking, control and other safety devices. Pursuant to post-*Gregg* legislation, the general rules and regulations of the Commission currently spell out detailed requirements with respect to equipment standards, require extensive inspections to assure compliance with such requirements and call for detailed regular reports showing compliance and for detailed accident reports, *see* 49 CFR, Pts. 91, 125, 131-136.

None of these laws and regulations dispense carriers from compliance because they are not generating net operating revenues sufficient to meet the costs of compliance. Trustees of a railroad in reorganization under Section 77 are specifically authorized to issue certificates of the highest security and priority, without regard to the pre-existing

liens or other priorities, for funds for safety equipment or related material, Section 77(c)(3) of the Bankruptcy Act, 11 U. S. C. § 205(c)(3) (1964). In the judgment of Congress, the national interest in the safety of employees, passengers and the bystanding public should not be frustrated for the sake of the financial interests of investors in railroads.

The six-months claims of many Petitioners arose from the sale of materials or supplies or the rendition of services necessary for the debtor's compliance with the foregoing safety laws and regulations.

A year after the *Gregg* decision, Congress also introduced an important new element to our national transportation policy. The Hepburn Act, Act of June 29, 1906, c. 3591, 34 Stat. 584, *required* carriers to furnish service "upon reasonable request therefor". National transportation policy was dramatically expanded by provision, in the Transportation Act of 1920 (now Section 1(18) of the Interstate Commerce Act, 49 U. S. C. § 1(18)(1964)), that a rail carrier may not abandon any operation until it shall first have obtained an adjudication from the ICC that the present or future public convenience and necessity permits such abandonment. The importance of this policy and its applicability to unprofitable rail carriers is evidenced by the related provisions of what is now Section 1(20) of the Interstate Commerce Act, 49 U. S. C. § 1(20) (1964): the creation of a right to injunctive relief and the imposition of criminal penalties against officers and "receivers or operating trustees" of a railroad responsible for an unauthorized abandonment. In later providing for the reorganization of insolvent railroads under the Bankruptcy Act, Congress specified that the trustees of such roads were equally bound by these provisions of the Interstate Commerce Act, *see* Section 77(o) of the Bankruptcy Act, 11 U. S. C. § 205(c) (1964).

It has been held that lack of funds to continue interstate railroad operations even for the period that may be required to pursue an abandonment application before the ICC does not warrant unilateral abandonment of service by the road. *Meyers* v. *Jay Street Connecting R. R.*, 259 F. 2d 532 (2d Cir. 1958), affirmed a preliminary injunction against unauthorized abandonment although it was undisputed that the railroad corporation had not the funds or credit to continue service. This same ruling was affirmed on review of the final injunction entered in that matter, 288 F. 2d 356 (1961).

The six-months claims of many Petitioners arose from the sale of materials or supplies or the rendition of services necessary for the continued operation of the debtor.

The post-*Gregg* enlargements of national transportation policy have obvious and important significance to federal judicial application of the six-months rule. The law of creditors' rights is not an island to remain isolated from, and unaffected by, national transportation law (Section 77, as noted above, is replete with references to the ICC and the Interstate Commerce Act and with requirements for approvals by the Commission and compliance with the Act). As observed by Mr. Justice Holmes on Circuit, *Johnson* v. *United States,* 163 F. 30, 32 (1st Cir. 1908), and reaffirmed by the Supreme Court, *United States* v. *Hutcheson,* 312 U. S. 219, 235 (1941).

> " . . . A statute may indicate or require as its justification a change in the policy of the law, although it expresses that change only in the specific cases most likely to occur in the mind. The Legislature has the power to decide what the policy of the law shall be, and if it has intimated its will, however indirectly, that will should be recognized and obeyed. . . ."

See also Girouard v. *U. S.*, 328 U. S. 61 (1946). *See* Landis, *Statutes and Sources of Law,* HARVARD LEGAL ESSAYS, 213 (1934), as to the duty of judges to search out the fullest implications of legislative policy and implement such policy in "common law" cases before them.

Petitioners perceive in the foregoing post-*Gregg* Federal railroad safety and service legislation a necessary policy implication with respect to six-months claims: The claims of those who have furnished insolvent railroads with the materials, supplies or services necessary for the safe continuation of their common-carrier activities should be entitled to a priority of payment in reorganization without regard to the adequacy of net railroad operating income for this purpose (that is, without regard to any metaphysical "fund" requirement). Extension of credit by six-months creditors is in the public interest and should be encouraged notwithstanding its minor impact on the reorganization recoveries of mortgage bondholders. The District Court overtly resolved the policy issues in the present case in favor of its own policy judgment that financially troubled railroads should seek reorganization sooner rather than later (although the ICC, the implementing tribunal for national transportation policy, had already expressed the view that the problems of the debtor could not be solved by reorganization, *see New York, N. H. & H. R. R. Loan Guaranty,* 312 ICC 300 (1960), 312 ICC 471 (1961); *Passenger Fares, New York, N. H. & H. R. R.,* 313 ICC 411 (1961)). In so doing, the District Court rejected what appeared to be necessary, indeed obvious, policy implications of congressional legislation in the national transportation field. The Court of Appeals, while not dealing explicitly with the relevant policy considerations, by its language and effect chose the judicial policy of 1905 over legislative policy articulated and implemented over the sixty years since the

Gregg case. This Court should now expressly consider whether six-months priorities should be limited to those tolerated by the *Gregg* decision notwithstanding the post-*Gregg* legislative developments.

B. This Case Presents an Important Question of Federal Law under the Bankruptcy Act.

Substantially all the debtor's revenues, cash, securities, bills, notes, accounts receivable, materials and supplies (collectively, "current assets") were expressly reserved and excepted from the liens of its mortgages "unless and until" there shall have been an event of default, "but upon the happening of any such event of default all such [revenues], cash, securities, bills, notes and accounts receivable and material and supplies shall immediately become subject to the liens hereof to the extent permitted by law". Those mortgages when executed and delivered did not grant, and expressly disclaimed the grant of, any security interest either in then existing current assets or in similar assets subsequently acquired by the debtor. Nor did the mortgages deprive the debtor of any element of dominion over its current assets. The mortgages were, in effect, agreements that, upon the occurrence of an event of default, the bondholders would obtain a security interest (a "springing lien") in such current assets as might at that time be owned by the debtor.

Section 77(b) of the Bankruptcy Act, 11 U. S. C. § 205(b) (1964), specifically provides that Section 60 of the Bankruptcy Act (voiding preferential transfers within four months of proceedings under the Act) applies in Section 77 proceedings. Section 77(c)(2) provides that the Statutory Trustees shall have all the title and shall exercise all of the powers of a trustee in bankruptcy. Section 77(*l*) provides that the rights and liabilities of cred-

itors, and of all persons with respect to the debtor and its property, shall be the same as if a voluntary petition in bankruptcy had been filed and granted the day the Section 77 petition was filed. It is thus the necessary implication of Sections 77(c)(2) and 77 (*l*) that Sections 67 and 70 of the Act also apply in Section 77 proceedings. So far as counsel for Petitioners are aware, however, the applicability of Sections 67 and 70 in Section 77 proceedings has not been judicially determined.

Section 60(a) of the Act defines a preference as a transfer.

> ". . . of any of the property of a debtor to or for the benefit of a creditor for or on account of an antecedent debt, made or suffered by such debtor while insolvent and within the four months before the filing by or against him of the petition initiating a proceeding under this title, the effect of which transfer will be to enable such creditor to obtain a greater percentage of his debt than some other creditor of the same class."

Section 60(b) provides for avoidance of a preference "if the creditor receiving it or to be benefited thereby . . . has, at the time when the transfer is made, reasonable cause to believe that the debtor is insolvent".

Section 67(d)(2) provides that

> ". . . every transfer made . . . by a debtor within one year prior to the filing of a petition . . . is fraudulent . . . as to creditors existing at the time of such transfer . . . if made . . . without fair consideration by a debtor who is . . . insolvent, without regard to his actual intent. . . ."

Section 70(e) provides that

> "(1) a transfer made or suffered . . . by a debtor adjudged a bankrupt . . . , which, under any Federal or State law applicable thereto, is fraudulent as against or voidable for any other reason by any creditor of the debtor . . . shall be null and void as against the trustee of such debtor.
>
> "(2) All property of the debtor affected by any such transfer shall be and remain a part of his assets and estate, discharged and released from such transfer. . . ."

Petitioner submits that in light of the plain meaning and policies of those sections, the springing liens created by the debtor's mortgages on its current assets are clearly a nullity. If any transfer of the debtor's current assets (or of a security interest therein) ever took place, it occurred on July 1, 1961, well within the one-year period referred to in Section 67 and the four-month period referred to in Section 60. The debtor was no less insolvent on July 1, 1961, than it was on July 7, 1961, when it filed its petition under the Bankruptcy Act and the mortgage bondholders, having bargained for that "transfer" upon the occurrence of an event of default, obviously contemplated and bargained for a "transfer" when the debtor was insolvent. The "transfer" bargained for was not in exchange for some new and fair consideration enhancing the debtor's estate but on account of an antecedent debt and would enable the mortgage bondholders—general unsecured creditors of the debtor to the extent of any deficiency claim—to obtain payment of a disproportionately larger percentage of their otherwise unsecured claim than would other general unsecured creditors.

Neither the Statutory Trustees nor the Mortgage Trustees could have abandoned the operations of the debtor

merely because those operations were unprofitable. Operation of the debtor during the reorganization proceedings, therefore, though economically disadvantageous to the mortgage bondholders was for their benefit in the sense that such operation satisfied statutory obligations imposed by Congress on the debtor by, *inter alia,* the Interstate Commerce Act, *see Pennsylvania R. R.-Merger-New York Central R. R.,* 331 ICC 643, 659 (1967). The Court of Appeals and the District Court, however, each considered the current assets of the debtor at the time of commencement of the proceedings as irrelevant to rights of the six-months claimants and the recoveries of the mortgage bondholders because those current assets were expended or consumed in the continued operation of the railroad. The courts below did not face up to the fact that if those current assets had not existed, the same bills would have been paid and additional bills would have been incurred and paid to purchase necessary stocks of materials and supplies, all at the expense of the mortgage bondholders in so far as funds for this purpose would have been raised by the flotation of trustees' certificates superior in right to the claims of the mortgage bondholders. To the extent that trustees' certificates were not issued because of the existence of $23,380,000 of current assets, the recovery of the mortgage bondholders will be enhanced by that amount and thus, in effect, the mortgage bondholders will be accorded the benefit of their "springing liens" notwithstanding the provisions of the Bankruptcy Act.

This Court should now expressly consider whether the "fair and equitable" standards of Section 77(e) prevent mortgagees as such from obtaining any greater recognition in a plan of reorganization than their valid property interests warrant and require that unsecured creditors be accorded recognition in the plan of reorganization to the extent of

the reorganization values directly or indirectly represented by the "free" assets of the estate in accordance with their respective priorities.

II. The Decision of the Court Below In This Case Is In Conflict With the Decision of Another Court of Appeals on the Same Matter.

As the issue is stated by the Court of Appeals below, there must be in existence "a fund consisting in effect of current assets" before priority can be accorded six-months creditors. One recent case decided by the Court of Appeals for the Fourth Circuit has held that no such fund is required for priority. There is therefore a conflict between the Circuits on an important question of the interpretation of the Section 77 of the Bankruptcy Act.

In *Southern Ry.* v. *Flournoy,* 301 F. 2d 847 (4th Cir. 1962), the Court was called upon to determine the relative priorities of six-months creditors and mortgagees in the assets, including mortgaged assets, of an insolvent railroad. The Court found that two basic objectives of railroad reorganization support the priority accorded six-months creditors, first the "public concern with the continued operation of the railroad", and second, the advantage to bondholders of having as their security "a live railroad", 301 F. 2d 847 at 853. Therefore, the security of bondholders may be displaced (even without regard to a "current expense fund") to meet these objectives so long as the supply creditors meet the usual requirements of the six-months rule and so long as, in effect, the claims of such creditors are for services or facilities which were "indispensable to [the railroad's] operation, so essential, in fact, that without them the road could not run", 301 F. 2d 847 at 854.

The Court should grant this petition to review the requirement of the Second Circuit that there must be a "current expense fund" as the basis for priority.

CONCLUSION

For the reasons set forth above, this petition for a writ of certiorari should be granted.

Respectfully submitted,

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March 10, 1969

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 32--September Term 1968

(Argued September 18, 1968 Decided December 9, 1968)

Docket No. 32017

In the Matter of The New York, New Haven and Hartford Railroad Company,

Debtor.

ALCO PRODUCTS, INC., et. al.

Appellants,

v.

TRUSTEES OF THE PROPERTY OF THE NEW YORK, NEW HAVEN AND HARTFORD RAILROAD COMPANY, et al.,

Appellees.

Before:

Lumbard, Chief Judge,
Waterman and Hays, Circuit Judges.

Appeal by unsecured creditors of The New York, New Haven and Hartford Railroad Company, the debtor in reorganization, from an order of the United States District Court for the District of Connecticut, Robert P. Anderson, *Circuit Judge,* denying their claims under the "six-months rule" for preferential treatment in the distribution of assets.

Affirmed.

Donald N. Dirks (Davis Polk & Wardwell, New York, N. Y.), *for Appellant Alco Products, Inc.*

John F. Hunt, Jr. (Cravath, Swaine & Moore, New York, N. Y., Michael G. Wolfson, of counsel), *for Appellants Bethlehem Steel Corporation, Westinghouse Air Brake Company, and Westinghouse Electric Corporation.*

John W. Barnett (Wiggin & Dana, New Haven, Conn., William J. Egan, of counsel), *for Appellants American Brake Shoe Company and Fourteen others,*

Jerome H. Shapiro (Gerald E. Dwyer, New York, N. Y.), *for Appellants The New York Central Railroad Company (now known as The Pennsylvania New York Central Transportation Company) and The Pittsburgh & Lake Erie Railroad Company.*

Arthur Latimer (Tyler, Cooper, Grant, Bowerman & Keefe, New Haven, Conn., Richard G. Bell on the brief), *for Appellant Texaco, Inc.,*

Robert W. Blanchette (James Wm. Moore & Robert W. Blanchette, New Haven, Conn., Joseph W. Bishop, Jr., Seymour N. Weinstein of counsel), *for Appellees Richard Joyce Smith and William J. Kirk, Trustees of the Property of The New York, New Haven and Hartford Railroad Company, Debtor,*

Albert X. Bader, Jr. (Simpson Thacher & Barlett, New York, N. Y., Horace J. McAfee, John J. McGraw, of counsel), *for Appellee Manufacturers Hanover Trust Company, as Corporate Trustee under The First and Refunding Mortgage of The New York, New Haven and Hartford Railroad Company,*

Wilkie Bushby (Dewey, Ballantine, Bushby, Palmer & Wood, New York, N.Y.), *for Appellee The Chase Manhattan Bank, as Corporate Trustee under the Debtor's General Income Mortgage,*

Lawrence W. Pollack (Migdal, Low, Tenney & Glass, New York, N.Y.), *for Appellee New York, New Haven and Hartford Railroad Company First Mortgage 4% Bondholders Committee,*

Walter A. Kernan (Carter, Ledyard & Milburn, New York, N. Y.), *for Appellee United States Trust Company, as Trustee under the Debtor's First Mortgage.*

Hays, Circuit Judge:

Appellants, unsecured creditors of The New York, New Haven and Hartford Railroad Company, the debtor in reorganization, filed timely claims in the railroad's reorganization proceedings for preferential treatment in the distribution of assets. Relying on the six-months rule they claim a priority aggregating $4,670,300.91 for services, parts and supplies. After a hearing the district court denied preferential treatment. We affirm.

The six-months rule stated briefly, gives priority in payment to creditors who, within a period of six months before the initiation of reorganization proceedings, have supplied materials or services necessary to keep the railroad running. *Lackawanna Iron & Coal Co.* v. *Farmers' Loan & Trust Co.*, 176 U. S. 298 (1900); *Southern Ry.* v. *Carnegie Steel Co.*, 176 U. S. 257 (1900); *Burnham* v. *Bowen*, 111 U. S. 776 (1884); *Johnson Fare Box Co.* v. *Doyle*, 250 F. 2d 656 (2d Cir.), cert. denied, 357 U. S. 938 (1958); FitzGibbon, The Present Status of the Six-Months' Rule, 34 Colum L. Rev. 230 (1934). This rule is based upon an equitable principle, i.e., that the public and the bondholders have profited by the continued operation of the railroad and that the supplier-creditors should not therefore bear the burden of the loss. Whether the six months creditors receive priority depends, however, on whether there existed a "current debt fund" or "current expense fund" from which payment could have been made but which was used instead for the benefit of the bondholders. The reasoning behind the requirement of the current expense fund is that the six months claims deserve priority only to the extent that the claimants relied in extending credit on the availability of current income and not, along with others, on the railroad's general credit standing. See *Fosdick* v. *Schall*, 99 U. S. 235 (1879). The issue in the present case is whether the New

Haven had at any relevant time a fund consisting in effect of current assets which equitable considerations require to be paid to the six months creditors but which by reason of the original mortgage security or the so-called springing liens has become an asset available to the bondholder.

It is conceded that under the system of accounting prescribed by the Interstate Commerce Commission the New Haven had no "net railway operating income" nor any net income whatsoever during the six months preceding the filing of the reorganization petition. No payments of interest on its bonds were made during that period. Interest payments made just before the beginning of the six months period were made from the proceeds of emergency loans guaranteed by the United States.

At the time of the filing of the petition the New Haven's current assets were approximately $23,000,000, its current liabilities more than $59,000,000. Since the railroad has been in reorganization its continued operation has been made possible only by borrowing money on trustees' certificates.

It is quite clear that under generally accepted accounting practices the New Haven had no income during the six months period before reorganization and has had no income since the reorganization proceedings were instituted. However, the claimants insist, in effect, that income be computed without regard to contemporaneous liabilities. For example, it is claimed that the trustees, on taking over the railroad, received over $6,000,000 in pre-reorganization income, although it was admittedly necessary for them to borrow some $8,000,000 to meet payrolls immediately after the takeover. But, to the extent that the six months rule is based on the reasonable expectations of the creditors to be paid out of current earnings, all the accrued expenses during the six months are deductible from gross revenues in computing the

fund, for at the time credit was extended no creditor was entitled to rely on claims going unpaid.

We hold that the availability of a current expense fund under the six-months rule is to be determined by generally accepted accounting practices, including those prescribed by the Interstate Commerce Commission, and that under those practices the current expense fund is to be computed by deducting operating expenses and depreciation from operating revenues. Applying this standard to the New Haven we find that there was no current expense fund available for payments under the six-months rule.

The railroad claimants have produced nothing that would lead to the grant of a special preference for the so-called per diem claims.

Affirmed.

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

At a Stated Term of the United States Court of Appeals, in and for the Second Circuit held at the United States Courthouse in the City of New York on the ninth day of December one thousand nine hundred and sixty-eight.

Present:

HON. J. EDWARD LUMBARD,
Chief Judge,

HON. STERRY R. WATERMAN,
HON. PAUL R. HAYS,
Circuit Judges.

IN THE MATTER
OF
THE NEW YORK, NEW HAVEN AND HARTFORD RAILROAD COMPANY,

Debtor,

ALCO PRODUCTS, INC., et al.,

Appellants,

Richard Joyce Smith and William J. Kirk, Trustees of the Property of The New York, New Haven and Hartford Railroad Company, Debtor, et al.,

Appellees.

Appeal from the United States District Court for the District of Connecticut.

This cause came on to be heard on the transcript of record from the United States District Court for the District of Connecticut, and was argued by counsel.

ON CONSIDERATION WHEREOF, it is now hereby ordered, adjudged, and decreed that the order of said District Court be and it hereby is affirmed with costs to be taxed against the appellants.

A. DANIEL FUSARO
Clerk

IN THE
UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF CONNECTICUT
IN PROCEEDINGS FOR THE REORGANIZATION
OF A RAILROAD

IN THE MATTER OF
THE NEW YORK, NEW HAVEN AND HARTFORD RAILROAD COMPANY,
Debtor.

No. 30226

MEMORANDUM OF DECISION ON PETITION BY SIX MONTHS CREDITORS FOR PRIORITY.

Several unsecured creditors of the New York, New Haven & Hartford Railroad, the Debtor in reorganization, have asserted claims to a priority in the assets of the Debtor based on the so-called "six months rule". For the reasons set forth below, these claims are not entitled to be paid on a priority basis which would have to be satisfied from the corpus[1] of the mortgaged property of the Railroad. Since it appears extremely unlikely that any assets other than corpus will be available after satisfaction of all claims prior to those of the mortgagees, it is unnecessary to make any further determination regarding six months claims at this time.

[1] "Corpus" is used throughout this opinion to refer to all property of the Railroad, both real and personal, originally described in the mortgages or which became subject to the liens of the mortgages as soon as the property was acquired; the term does not include cash, receivables and such other current assets which became subject to the mortgages, as a "spring lien," only upon a default.

The "six month rule" was developed in railroad equity receiverships during the late nineteenth century.[2] By 1900 the rule had been stated and applied with sufficient inconsistency to cause the Supreme Court to remark:

> "It is apparent from an examination of the above cases that the decision in each one depended upon its special facts. This court has uniformly refrained from laying down any rule as absolutely controlling in every case . . ."

Southern Railway Co. vs. *Carnegie Steel Co.*, 176 U.S. 257, 284-285 (1900). With one exception,[3] the principal decisions on the six months rule since 1900 have been made by lower federal courts,[4] and these decisions have hardly clarified the situation. One court recently commented:

> "'The researches of counsel supplemented by such research as has been at my command have not resulted in the discovery of any principle which would

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[2]Priorities which would have been granted in an equity receivership are applicable in present-day railroad reorganizations by virtue of § 77(b) of the Bankruptcy Act, 11 U. S. C. § 205(b):

> "For all purposes of this section unsecured claims, which would have been entitled to priority if a receiver in equity of the property of the debtor had been appointed by a Federal court on the day of the approval of the petition, shall be entitled to such priority and the holders of such claims shall be treated as a separate class or classes of creditors."

[3]*Gregg* v. *Metropolitan Trust Co.*, 197 U. S. 183 (1905).

[4]The most frequently cited of these is *Guaranty Trust Co.* v. *Albia Coal Co.*, 36 F. 2d 34 (8 Cir. 1929) which is referred to for its dicta because the case merely held that the order before it was not appeallable. Second Circuit decisions include *Taylor* v. *Delaware & E. R. Co.*, 213 Fed. 622 (2 Cir. 1914); *Pennsylvania Steel Co.* v. *New York City Ry. Co.*, 216 Fed. 458 (2 Cir. 1914), 198 Fed. 721 (1912); *Dudley* v. *Mealey*, 147 F. 2d 268 (2 Cir.), cert. denied, 325 U. S. 873 (1945); *In Re Third Avenue Transit Corporation*, 230 F. 2d 425 (2 Cir. 1956), aff'ng 138 F. Supp. 623 (S. D. N. Y. 1955); *Johnson Fare Box Company* v. *Doyle*, 250 F. 2d 656 (2 Cir. 1958); *In Re Chicago Express, Incorporated*, 332 R. 2d 276 (2 Cir. 1964).

> account for all of the decisions or even enough of the decisions so that one might say that there was a principle behind them."[5]

In Re Third Avenue Transit Corporation, 138 F. Supp. 623, 627 (S.D.N.Y. 1955), aff'd per curiam, 230 F.2d 425 (2 Cir. 1956). In construing the rule at the present time, ambiguities must generally be resolved against those claiming the benefit of the rule:

> "The so-called six months' priority rule is an invasion of the established contract rights of lienholders. As an invasion the rule should be strictly contained within narrow confines and limited to the purposes which brought it into being."
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> *Johnson Far Box Company* vs. *Doyle,* 250 F.2d 656, 657 (2 Cir.), *cert. denied* 357 U.S. 938 (1958).[6]

In broad terms the six months rules provides that claims for labor, supplies and material furnished to the debtor-railroad shortly before reorganization shall to a certain extent be afforded a priority in the debtor's assets. It has been generally held that certain requirements must be met in order for the rule to apply:

(1) The claim must have accrued within a reasonably short period prior to reorganization (usually six months). *Southern Railway Co.* vs. *Carnegie Steel Co., supra* at 292.

(2) The claim must be for a current expense in the ordinary operation of the railroad necessarily incurred to

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[5]This statement was quoted in excerpted form with approval in *Johnson Fare Box Company* v. *Doyle,* 250 F. 2d 656, 657 (2 Cir. 1958).

[6]Cf. *Kneeland* v. *American Loan & Trust Co. of Boston,* 136 U. S. 89, 97-98 (1890).

keep it running. *Burnham* vs. *Bowen,* 111 U.S. 776, 780 (1884).

(3) The claimant, when furnishing labor, supplies, or material, must have relied on the railroad's current earnings for payment of his claim, and not on the railroad's general credit. *Southern Railway Co.* vs. *Carnegie Steel Co., supra* at 285.

> *Guaranty Trust Co.* vs. *Albia Coal Co.,* 36 F.2d 34 (8 Cir. 1929); *FitzGibbon, The Present Status of the Six Months' Rule,* 34 Column. L. Rev. 230, 235-236 (1934).[7]

The Supreme Court's first statement of the rule, *Fosdick* v. *Schall,* 99 U. S. 235 (1879), remains as clear as anything thereafter handed down.[8]

> "The business of all railroad companies is done to a greater or less extent on credit. This credit is longer or shorter, as the necessities of the case require; and when companies become pecuniarily embarrassed, it frequently happens that debts for labor, supplies, equipment and improvements are permitted to accumulate, in order that bonded interest may be paid and a disastrous foreclosure postponed, if not altogether avoided. In this way *the daily and monthly earnings,* which ordinarily should go to pay the *daily*

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[7]In view of the basis for the present decision it is not necessary to decide now whether any or all of the claims here asserted satisfy any or all of these three requirements.

[8]Later Supreme Court cases concerned with the six months rule are *Burnham* v. *Bowen,* 111 U. S. 776 (1884); *St. Louis, A. & T. H. R. R. Co.* v. *Cleveland, C., C. & I. R. Co.,* 125 U. S. 658 (1888); *Morgan's Louisiana and Texas R. & S. Co.* v. *Texas Central R. Co.,* 137 U. S. 171 (1890); *Thomas* v. *Western Car Co.,* 149 U. S. 95 (1893); *Virginia & A. Coal Co.* v. *Central R. & B. Co.,* 170 U. S. 355 (1898); *Southern Railway Co.* v. *Carnegie Steel Co.,* 176 U. S. 257 (1900); *Gregg* v. *Metropolitan Trust Co.,* 197 U. S. 183 (1905).

and monthly expenses, are kept from those to whom in equity they belong, and used to pay the mortgage debt. The income out of which the mortgagee is to be paid is the net income obtained by deducting from the gross earnings what is required for necessary operating and managing expenses, proper equipment and useful improvements. Every railroad mortgagee in accepting his security impliedly agrees that the current debts made in the ordinary course of business shall be paid from the current receipts before he has any claim upon the income. If for the convenience of the movement something is taken from what may not improperly be called *the current debt fund,* and put into that which belongs to the mortgage creditors, it certainly is not inequitable for the court, when asked by the mortgagees to take possession of the future income and hold it for their benefit, to require as a condition of such an order that what is due from the earnings to the current debt shall be paid by the court from the future current receipts before anything derived from that source goes to the mortgagees . . .

[I]f it appears in the progress of the cause that bonded interest has been paid, additional equipment provided, or lasting and valuable improvements made out of earnings which ought in equity to have been employed to keep down debts for labor, supplies and the like, it is within the power of the court to use the income of the receivership to discharge obligations which, but for the diversion of funds, would have been paid in the ordinary course of business."

* * *

"The power rests upon the fact, that in the administration of the affairs of the company the mortgage

> creditors have got possession of that which in equity belonged to the whole or a part of the general creditors. Whatever is done, therefore, must be with a view to a restoration by the mortgage creditors of that which they have thus inequitably obtained. It follows that if there has been in reality no diversion, there can be no restoration; and that the amount of restoration should be made to depend upon the amount of the diversion." [Emphasis added.]

99 U. S. at 254. The rationale of the rule as stated in *Fosdick* vs. *Schall* is an equitable distribution of the railroad's operating revenues, to which the Court says the mortgagees "impliedly agree".[9] Revenues accruing from operations

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[9]This basic concept persists throughout the Supreme Court cases on the six months rule. See, e.g., *Burnham* v. *Bowen,* 111 U. S. 776 (1884):

> "[A]ll parties understanding that current expenses are to be paid out of current earnings" 111 U. S. at 780.
>
> "All we then [*Fosdick* v. *Schall*] decided, and all we now decide is, that if current earnings are used for the benefit of mortgage creditors before current expenses are paid, the mortgage security is chargeable in equity with the restoration of the fund which has been thus improperly applied to their use." 111 U. S. at 783.

St. Louis, A. & T. H. R. R. Co. v. *Cleveland, C., C. & I. R. Co.,* 125 U. S. 658 (1888):

> "[O]perating expenses . . . are chargeable upon gross income before net revenue arises which constitutes the fund applicable to the payment of the interest on the mortgage bonds." 125 U. S. at 673.

Southern Railway Co. v. *Carnegie Steel Co.,* 176 U. S. 257 (1900):

> "[I]t may be safely affirmed, upon the authority of former decisions, that a railroad mortgagee when accepting his security impliedly agrees that the current debts of a railroad company contracted in the ordinary course of its business shall be paid out of current receipts before he has any claim upon such income . . . and that when current earnings are used for the benefit of mortgage creditors before current expenses are paid, the mortgage security is chargeable in equity with the restoration of any funds thus improperly diverted from their primary use." 176 U. S. at 285.

should be paid first to the operations creditors whose materials and services made those revenues possible; and only after all such operational claims have been paid, should the balance be available for the benefit of the mortgagees. If any operating revenues do improperly get into the hands of the mortgagees, equity requires that those revenues be restored to the operations creditors by the mortgagees, yielding them a priority.[10]

The two basic questions raised by the claims presently made are: (1) does the financial history of the New Haven Railroad from January 1, 1961, show that there is presently, in the words of the *Fosdick* case, "a current debt fund" (later referred to as "a current expense fund") out of which the petitioning six months creditors would be entitled to a priority payment; and (2) from what assets, if any, of the debtor's estate may these priority payments be made?

Such a fund may arise out of one or more of the following: (a) current earnings in the sense of surplus earnings during the six months period and during the reorganization itself; (b) unmortgaged assets of the debtor; and (c) income diverted during the six months period or during the reorganization for the benefit of the mortgagees.

Although most of the Supreme Court cases have used the terms "current receipts" or "current earnings" as a

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[10]Most cases contain additional rhetoric to the effect that extensions of credit by those furnishing operating services and materials have "kept the railroad running". This continued operation of the railroad is then said to be a benefit to the public and to the mortgagees as well, because the railroad is worth more as a going concern than its liquidation value. Hence a priority should be granted to the operations creditors. However, given the railroad reorganization provisions of § 77 of the Bankruptcy Act (11 U. S. C. § 205), it is simply not true in circumstances like those facing the New Haven that extension of credit by suppliers of operating materials and services keep a railroad from ceasing to run. *Should these suppliers withhold credit and demand cash, the railroad would not go into liquidation; it might have to go into reorganization so much the sooner, but it would keep running until a plan of reorganization was approved or liquidation was decreed.*

source of this fund, several lower federal courts have used the word "income". See, *e.g., Guaranty Trust Co.* vs. *Albia Coal Co., supra.* As a result, the New Haven's mortgagees have argued that the fund is equal to the Railroad's "income" or "net income" either as determined by ordinary accrual accounting or by accounting procedures prescribed by the Interstate Commerce Commission for rate-making purposes. The difficulty with this argument is that it fails to take into account the effect of the petition for reorganization. After the petition was filed, many operating expenses which had accrued during the previous six months were not and will not be paid, although the Trustees have been required to pay some of those expenses, and payments of some taxes have simply been deferred by court order. To the extent that expenses merely accrue but are never paid, revenues available for payment to operations creditors are in fact not reduced.

The current expense fund available from earnings can be defined, therefore, as the sum of all operating revenues which have accrued during the six months period and in the course of reorganization, and which have actually been received or taken over by the Trustees, less depreciation and all operating expenses which have actually been paid or are payable by the Trustees or which constitute administration expenses.[11]

This definition of the fund differs from that in the frequently cited case of *Guaranty Trust Co.* vs. *Albia Coal Co., supra,* principally because it provides for the deduction from any gross operating income which accrued during the six months period and *which was taken over or collected by the Trustees, expenses* for items of the accounts payable of the

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[11]These operating expenses include rents paid, taxes paid, and taxes, the payment of which has been deferred by order of the court. Income, in accounting classifications, for the years 1958 through 1965 is as shown in appendix hereto attached.

Railroad on July 7, 1961 (the date of the filing of the petition) which the Trustees were required to pay. See *Fitz-Gibbon, The Present Status of the Six Months Rule,* 34 Colum. L. Rev. 230, 245-246 (1934). The *Guaranty* case treated the fund for the six months period which it defined, as just stated, as "gross operating income taken over or collected by the Receiver less accrued taxes", separately from the fund for the period of the reorganization which it defined as "net operating income". This was apparently done because, as also stated above, many operating expenses which accrued during the six months period go unpaid, whereas those accruing during reorganization are paid as administration expenses. The Supreme Court, however, has generally treated both periods in the aggregate, for the purpose of the six months rule, as the continuous operation of the railroad. *Burnham* vs. *Bowen, supra.*

Many of the claimants argue, in effect, that, for the purpose of the six month creditors rule, accounting terms cannot be given the meaning accorded them under generally accepted principles or systems of accounting or under those prescribed for railroads by the Interstate Commerce Commission because, they assert, no such recognized accounting method is applicable or even relevant to the rule which is an equitable concept developed by the courts which requires an unorthodox juggling of income and expenses, and current assets and liabilities, to carry out its spirit and its purpose, and, at least in this case, assure the claimants a fund out of which they may be paid. They superimpose upon this idea the claim that, if any time even for the shortest conceivable interval in the six months preceding the filing of the petition in reorganization or in the course of the organization itself, such a fund can be said to appear, it is forthwith branded with an equitable lien for the six months creditors and thereafter remains a kind of trust fund which can be used for no other purpose and is finally distributed to the claimants.

Neither of these concepts is tenable. The words used must be interpreted in the light of a generally recognized accepted system of accounting. The rule, of course, requires the elimination as expenses or liabilities of interest or principal payments and any diversions (more fully discussed infra) to the mortgagees. While a rigid and mechanistic application of accounting terms should not be adopted to thwart the equitable consideration which the courts have afforded six month claimants, such terms, recognized and used for more than half a century, should not be so distorted for the purpose of granting the six months creditors a recovery, that the terms no longer relate to the concept for which they have traditionally stood and are no longer descriptive of the Railroad's financial operations. The phrase "generally accepted accounting principles" does not mean precisely the same thing in all businesses because allowances must be made as the Interstate Commerce Commission has said, 309 I.C.C. 289, 293 (1959), "for variations among different industries because of special conditions or long-established usage." As far as this present case is concerned, any difference between the Interstate Commerce Commission's prescribed system of accounting for railroads and "generally accepted accounting principles" is minor and falls within the tolerance which the generally accepted practice allows for the railroad industry. Whatever accounting theories and practices may have been used by the different railroads in the cases which were before the Supreme Court from *Fosdick* vs. *Schall, supra,* to and including *Gregg* vs. *Metropolitan Trust Co.,* 197 U.S. 183, 188 (1905) it is apparent that the receipts out of which "the current debt fund" or "the current expense fund" may be created is what is referred to in the *Gregg* case as "the surplus earnings, if any, in the hands of the receiver . . ." See also subsequent lower court decisions, *Taylor* vs. *Delaware & E. R. Co.,* 213 Fed. 622, 624 (2 Cir. 1914); *Texas*

Co. vs. *International & G. N. Ry. Co.*, 237 Fed. 921, 926-927 (5 Cir. 1916); *Moore* vs. *Donahoo*, 217 Fed. 177 (9 Cir. 1914). *Cutcheon, Recent Developments in Federal Railroad Foreclosure Procedure in Some Legal Phases of Corporate Financing, Reorganization and Regulation* 79 (1931) which says, p. 106, that six months claims are "preferred over the lien of a mortgage and the claims of bondholders *as to net income, whether that of the railroad company or that of its receivers.*" [Emphasis added.] This description of the rule was quoted as having "very general acceptance" in *In re Third Avenue Transit Corporation, supra.*, and was cited again in *In re Chicago Express, Incorporated*, 332 F.2d 276, 278 (2 Cir. 1964). See also *FitzGibbon, The Present Status of the Six Months Rule*, 34 Colum. L. Rev. 230, 243 (1934); *Finletter Bankruptcy Reorganization* 377 (1939).

The claimants' argument which in effect would impress a temporary showing at some point from January 1, 1961 to the present of net operating profit with an equitable lien which would remain operative through distribution has been rejected by this Circuit. *In re Chicago Express, Incorporated, supra*, at 278. The presence or absence of a fund out of which the six months claimants can be paid must be determined as of the time of distribution and not as of some earlier time such as the moment of the filing of the petition for reorganization or the day on which the Trustees show the greatest earnings from operations.

The Trustees assert that the only fair method of computing income as a source of the fund for the purpose of the six months creditor rule is to take the income which is available for fixed charges. Some of the bondholders object that this formula would unduly benefit the six months claimants because it would include miscellaneous income not generated by the supplies or services furnished by the six

months creditors.[12] Perhaps, as they say, net railway operating income would be a more correct and authoritative well spring for the fund. In any event, it is unnecessary to resolve these conflicting claims here because even if the income available for fixed charges were adopted as the source for the current expense fund, there would, as matters now stand and as they have stood throughout the reorganization proceedings, be no current expense fund.[13] Moreover, it is highly unlikely that there ever will be one. As there have been no surplus earnings from which a current expense

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[12]These claimants have argued that non-operating revenues should be included in the current expense fund; but such a proposition is inconsistent with the rationale of the rule that operations creditors should have a priority in those revenues which they help to produce. *New York Dock Co.* v. *Poznan,* 274 U. S. 117, 121 (1927); *In re Chicago Express, Incorporated,* 332 F. 2d 276, 278 (2 Cir. 1964); *FitzGibbon, The Present Status of the Six Months Rule,* 34 Colum. *L. Rev.* 230, 243 (1934). Whether the rentals received from the Grand Central properties are operational or non-operational revenues need not be decided for the purpose of this case because, even if they are considered to be operational, there would still be no surplus earnings for such a fund.

[13]The claimants argue that irrespective of what conclusions may be drawn from the income account, the balance sheet for June 30, 1961 shows current assets of $23,380,423 which were "taken over or collected" by the Trustees which constitutes a fund from which they are entitled to have a priority payment of their claims. The statements of current assets and liabilities both for December 31, 1960 and June 30, 1961 are as follows:

Current Assets:	12/31/60	6/30/61
Cash	$ 2,394,054	$ 4,025,567
Special Deposits	1,800,533	754,154
Net Balance Receivable from Agents and Conductors	2,686,173	2,631,992
Miscellaneous Accounts Receivable	4,416,080	3,340,345
Interest and Dividends Receivable	60,631	64,762
Accrued Accounts Receivable	3,221,781	3,638,360
Working Fund Advances	181,847	184,422
Prepayments	852,532	1,227,998
Material and Supplies	7,567,245	7,395,599
Other	47,345	27,224
Total	$23,228,221	$23,380,423

fund could be derived there remains the question whether the priority of the six months claims should be satisfied out of the assets of the Debtor Railroad.

The first source for satisfaction of the priority is the unmortgaged assets of the Railroad. *Pennsylvania Steel Co.* vs. *New York City Ry. Co.*, 216 Fed. 458, 471 (2 Cir. 1914). But the New Haven Railroad has none and the issue then arises to what extent the priority should displace the mortgage liens. These liens generally cover (1) all of the

Current Liabilities:	12/31/60	6/30/61
Loans and Notes Payable	$ 4,500,000	$13,000,000
Traffic and Car Service Balances..	5,906,146	8,024,680
Audited Accounts and Wages Payable	9,476,834	10,508,367
Miscellaneous Accounts Payable..	1,979,429	1,810,802
Interest Matured Unpaid	2,374,501	2,305,531
Dividends Matured Unpaid	27,090	27,020
Unmatured Interest Accrued	258,831	316,317
Current Portion of Injuries and Damages Reserves	3,825,000	3,825,000
Accrued Vacation Pay		4,704,929
Other Accrued Accounts Payable.	6,576,839	6,418,089
Federal Income Taxes Accrued...	267,594	159,000
Other Taxes Accrued	6,827,676	6,795,352
Other	2,752,613	1,795,802
Total	$44,772,553	$59,690,889

If there are subtracted from the current liabilities for June 30, 1961, the loans and notes payable of $13,000,000 and the interest and dividend items amounting to $2,648,868 or a total of $15,648,888, there remain as current liabilities $44,042,001 which exceed the current assets by $20,661,578. Of course as previously mentioned all of these liabilities have not been paid and some never will be paid, but the testimony at the hearing showed and the court finds that all of the current assets were more than offset by current liabilities totalling substantially in excess of $25,000,000 which the Trustees were required to pay and did pay or which were accrued taxes, payment of which has been deferred by court order. Therefore, nothing has remained in their hands which was "taken over and collected" by them which could constitute a source for a current expense fund. It should be noted that no attempt has been made to give consideration to that portion of the current assets of June 30, 1961 which came from the $8,500,000 borrowed on Government guaranty during the six months period which could not very well qualify under any definition as a source for priority payment of six months creditors' claims.

Railroad's property, including that acquired after the initial mortgage, and (2) *once default takes place,* all the Railroad's revenues and certain current assets such as cash and receivables. The former category is universally referred to in the six months cases as the "corpus" of the mortgaged property. The latter category—so-called "springing liens"—directly conflicts with the rationale of the six months rule and the rule effectively displaces these liens to the extent of the claims which come within it.[14] No case has ever questioned that such current assets may be used to satisfy the operations creditor's priority. Non-corpus assets, however, are frequently, as is true in the present case, insufficient for a priority fund, and the critical question then becomes to what extent it may be satisfied out of the corpus of the mortgaged property.

On the question of invasion of corpus the Supreme Court has consistently held in every decision on the point that corpus cannot be invaded to satisfy the priority of the operations creditors *except to the extent that the current expense fund has been "diverted" to the benefit of the mortgagees. See, e.g., Fosdick* vs. *Schall, supra.,* at 254 ("[I]f there has been in reality no diversion, there can be no restoration; . . . the amount of restoration should be made to depend upon the amount of the diversion."); *St. Louis, A. & T. H. R. R. Co.* vs. *Cleveland, C. C. & I. R. Co.,* 125 U. S. 658, 674 (1888); *Gregg* vs. *Metropolitan Trust Co., supra.*[15] This limiting of corpus invasion to the amount of

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[14]In the New Haven's mortgages these springing liens are qualified by the phrase "to the extent permitted by law".

[15]One lower federal court has misread the Supreme Court's holdings on this point. *Southern Railway Company* v. *Flournoy,* 301 F. 2d 847 (4 Cir. 1962). The *Flournoy* court confused and merged the six months rule with another priority developed in equity receiverships: the so-called "necessity of payment" rule. This rule is completely unrelated to the six months rule, with different requirements and a different rationale. The necessity of payment rule was first enunciated in *Miltenberger* v. *Logansport Ry.,* 106 U. S. 286 (1882); there it was held that if *payment* of a claim which arose prior to re-

the fund is entirely consistent with the rationale of the rule. If the current revenues to which operations creditors are entitled, have never benefited or been diverted to the mortgagees, the operations creditors have no right to invade the interests of the mortgagees. The rule states that mortgagees shall not take any of the operating revenues until the operations creditors have been paid; if the mortgagees have never received any such revenues, they are not bound to restore any.[16]

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organization *is necessary for the continued operation of the railroad during reorganization,* (e.g., if a previously unpaid creditor occupies a monopoly position vis-a-vis the railroad during reorganization and threatens to withhold his supplies unless paid) then the trustee is authorized to pay that claim even out of corpus if necessary. The rationale of the rule is that the interests of all parties, including the public and the mortgages, are best served by the continued operation of the railroad. Diversion is obviously irrelevant to the necessity of payment rule as are also such requirements of the six months rule as reliance on current earnings and accruing of the claim shortly before reorganization. The *Flournoy* court inexplicably merged the two rules by making necessity of payment a requirement of the six months rule and eliminating diversion as a requirement for corpus invasion. This was directly contrary to *Gregg* v. *Metropolitan Trust Co.,* 197 U. S. 183 (1905), where the Supreme Court in an opinion by Justice Holmes unequivocally held that necessity of payment rule's lack of a diversion requirement for corpus invasion was not to be transposed to the six months rule; the former rule, the Court held, was based merely on the ***necessity of payment*** while the latter rule was based merely on the ***necessity of the service or supply furnished.*** 197 U. S. at 187. See also *Taylor* v. *Delaware & E. R. Co.,* 213 Fed. 662, 624 (2 Cir. 1914). The two rules are also apparently inadvertently merged in 6A Collier, Bankruptcy (1965) § 9.13 [5].

Some of the New Haven's creditors claim to qualify for a preference under the necessity of payment rule. As the railroad has been operating in reorganization for six years without payment of these claims, it is absurd to contend that it is necessary for continued operation of the railroad that the claims be paid. It may be that some of the New Haven's creditors occupied a sufficiently monopolistic position so that they could have forced payment; the fact is that they did not. The necessity of payment rule is not based on considerations of equity but is rather a device for handling a threat to the continued operation of the railroad during reorganization. If there is no such threat, the rule is not applicable.

[16]Some claimants have argued that diversion is no longer required for corpus invasion after *New York Dock Co.* v. *Poznan,* 274 U. S. 117 (1927). That case dealt with an entirely different situation; namely, services rendered to property while that property was in the custody of the court.

The term "diversion" refers to a benefit to the mortgagees which is paid out of revenues which should have gone into the current expense fund. Such benefits to the mortgagees have been held to include payment of principal or interest, *Fosdick* vs. *Schall, supra,* at 253; *Southern Railway Co.* vs. *Carnegie Steel Co., supra,* at 295, and all increments in the mortgage security, such as capital improvements to mortgaged property, *Fosdick* vs. *Schall, supra; Southern Railway Co.,* vs. *Carnegie Steel Co., supra; Virginia & A. Coal Co.* vs. *Central R. & B. Co.,* 170 U. S. 355, 369-370 (1898), new acquisitions of property subject to the mortgage, *Gregg* vs. *Mercantile Trust Co.,* 124 Fed. 721, 722 (6 Cir. 1903), *aff'd* 197 U. S. 183 (1905); *In Re Minneapolis & St. Louis RR,* (D. Minn. 1926) unreported memorandum at pp. 3408-3421 of Minneapolis & St.Louis RR Receivership Record, and, under circumstances distinguishable from that of the New Haven, payments of equipment trust obligations.[17] But when these benefits are paid, not out of earnings which qualified for the current expense fund, but out of what are called "free funds", then

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[17] *In Re Minneapolis & St. Louis RR,* (D. Minn. 1926), unreported memorandum at pp. 3408-21 of Minneapolis & St. Louis RR Receivership Record; *Southern Railway Co.* v. *Carnegie Steel Co.,* 176 U. S. 257, 295 (1900); ("car trust debts"); *Burnham* v. *Bowen,* 111 U. S. 776, 782 (1884) ("fixed charges on railroad structures"); *Gregg* v. *Mercantile Trust Co.,* 109 Fed. 220, 229 (6 Cir. 1901). The theory of these holdings is apparently that once all payments have been made, title to the equipment will pass to the railroad and hence the asset will become part of the mortgage security. See footnote 21 infra.

The mortgage security is also increased, some of the claimants argue, when the railroad pays off debts to other parties which were prior to mortgage liens. While such payments might as a practical matter improve the financial position of the mortgagees, they do not increase the mortgage security but merely restore some of the effectiveness of it for the mortgagees. Cf., *St. Louis, A. & T. H. R.* v. *Cleveland C., C. & I. R. Co.,* 125 U. S. 658, 676-77 (1888) and *Central Trust of New York* v. *East Tennessee V. & G. R.R.,* 80 Fed. 624, 625, holding interest payments to senior mortgages are not diversions to junior mortgagees.

they are not diversions. See *Gregg* vs. *Mercantile Trust Co., supra, at 72.* Such free funds have been held to include additional borrowings by the railroad,[18] proceeds from sales of mortgaged property,[19] and non-operating income.[20]

The six months creditors make several claims of diversion of current operating revenues to the mortgagees. They argue that allowances in the income account for depreciation are expenditures for capital assets and are, in effect, diversions from current earnings for the benefit of the mortgagees. Depreciation, however, does not create additions to assets or accessions to assets already held, but is a reflection of the very real economic fact that the assets are being consumed or wasted away in the process of keeping the railroad running and is actually a measure of the contribution of physical properties made by the mortgagees for this purpose. Therefore, to the extent of depreciation, operations creditors have no equitable claim on operating revenue; they have no equitable right to be protected from the phenomenon of depreciation. *Contra, Flint* vs. *Danbury & Bethel Street Ry Co.,* 101 Conn. 13, 125 Atl. 194 (1924); also *contra* but allowing other off-setting liabilities, *Guaranty Trust Co.* vs. *Minneapolis & St. Louis R. R. Co.,* Receivership Record Vol. XIV, p. 8199 (D. Minn. 1926).

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[18]*St. Louis, A. & T. H. R.* v. *Cleveland C., C. & I. R. Co.,* 125 U. S. 658, 674-678 (1888); *Central Trust of New York* vs. *East Tennessee V. & G. R.R.,* 80 Fed. 624, 625-626 (6. Cir. 1897). It is irrelevant whether the loan proceeds went directly to benefit the mortgagees or replaced revenues which had benefited the mortgagees. *Central Trust Co. of New York* vs. *East Tennessee, V. & G. R.R., supra.*

[19]*In Re Minneapolis & St. Louis RR,* (D. Minn. 1926), unreported memorandum at pp. 3408-21 of Minneapolis & St. Louis RR Receivership Record; FitzGibbon, The Present Status of the Six Months Rule, 34 Colum. L. Rev. 230, 245 (1934).

[20]*In Re Minneapolis & St. Louis RR.,* (D. Minn. 1926), unreported memorandum at pp. 3408-21 of Minneapolis & St. Louis RR Receivership Record. Cf., *Gregg* v. *Mercantile Trust Co.,* 124 Fed. 721 (6 Cir. 1903), aff'd 197 U. S. 183 (1905) [revenues accruing before six months period but collected during that period are "free funds"]. Other free funds of the New Haven's are the various grants in aid received from some of the states which the New Haven serves.

Allowance of depreciation is comparable to expenditures made merely to preserve and not to increase the mortgaged assets and as such are not diversions. *Burnham* vs. *Bowen, supra* at 781-782. Improvements to repair and restore property are not diversions. *St. Louis, A. & T. H. R. R. Co.* vs. *Cleveland, C., C. & I. R. Co., supra* at 667-678. Diversion is the channelling of operating revenues for the enhancement of the railroad's mortgaged assets; depreciation is just the opposite—the steady consumption of the mortgagee's security by the operation of the railroad.

The six months creditors assert there were also diversions during the six months period through the payment of interest on the Harlem River Division mortgage and on the First and Refunding Mortgage. It is clear that these payments were made from the proceeds of Government guaranteed loans and were not made from current operating income. Likewise, payments during the six months period of principal and interest on certain bank loans, emergency loans and Flood and Shop loans, were not made from operating income which otherwise would have gone into a current expense fund, and in any event the payments did not benefit the mortgagees. A reduction in the Harlem River Division mortgage debt was made with the proceeds of the sale of the mortgaged assets.

Some claimants have argued that there has been diversion in payment by the New Haven of substantial sums in fulfillment of its equipment trust and conditional sales obligations. However true this might be under normal conditions, in the circumstances under which the New Haven has operated since a time prior to the six months preceding the reorganization, there has been no income available for fixed charges. As the result of this, the interests of the Railroad which have been mortgaged to the bondholders are actually impaired by the payments of these obligations.[21]

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[21]For example assume an acquisition of $3,000,000 in equipment under either equipment trust or conditional sale. The equipment obli-

Witnesses for the Railroad's Trustees have testified that the sum of all payments of principal and interest and all improvements to, and new acquisitions of, mortgaged property are substantially less than the sum of all additional borrowings and sales of mortgaged property, and then the court so finds. Not a single claimant has challenged the accuracy of the testimony at the hearing or in the briefs filed.

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gation is for 15 years, providing for interest at 4.87%, payable semi-annually. It is assumed that the equipment has a useful life of 20 years, at the end of which there will be a 2% net salvage value.

In each year, the principal of the obligation will be reduced by $200,000; annual depreciation charges will be $147,000 and annual interest payments will average $84,282. The balance sheet accounting entries will be as follws: Upon acquisition, an asset of $3,000,000 is added, and a liability in equal amount is also created. As payments are made on principal, the balance sheet liability is reduced by $200,000 annually. Correspondingly, cash is also reduced by $200,000, plus the amount of interest paid. Each year the net book value of the asset is reduced by $147,000, reflecting the depreciation. On the income account, annual depreciation of $147,000 is taken as a charge against revenues. The interest payment is reflected as a fixed charge; it is deducted only *after* arriving at the figure designated "Income Available for Fixed Charges."

At the end of 15 years, principal payments will total $3,000,000, and interest payments will aggregate $1,264,234. The total cash outlay will thus be $4,264,234. At the end of 15 years, the equipment will be carried on the balance sheet at $795,000 with nothing owed thereon. Depreciation charges would have aggregated $2,205,000.

Under normal circumstances, the owner's equity would have benefited by $795,000, the difference between the amount of the principal payments and the depreciation (reflecting the decrease in value with use) over 15 years. However, cash outlays for interest of $1,264,234 were required to reach this result. Normally, since there is income available for fixed charges, the owner of the enterprise does not suffer an impairment of his equity.

On the other hand, if there is a deficit in income available for fixed charges, the cash which must be paid as interest impairs the owner's equity. A deficit in this account means that after other expenses and charges for depreciation, revenues are insufficient to meet interest payments. In the above illustration cash of $4,264,234 was required to discharge the obligation. A non-cash charge to income was depreciation in the amount of $2,205,000. Accordingly, if there is a deficit in income available for fixed charges throughout the 15-year period, corpus will be impaired by the difference between $4,264,234 and $2,205,000, or $2,059,234. Assuming that the asset is worth its net book value of $795,000 after 15 years, the owner has suffered a net loss in equity of $1,264,234.

Not only has there been no diversion to the New Haven's mortgagees, but when one considers the Railroad's annual depreciation, for example, about $9,000,000 a year on way and equipment, it becomes clear that there has been a steady drain of security away from the mortgagees. Hence the New Haven's situation is precisely the opposite of the one for which the six months rule was devised. Instead of surplus earnings being applied to the enhancement of mortgaged assets, the expenses of operation have vastly exceeded income and have been paid out of corpus. Because there has been no diversion to the New Haven's mortgagees, no six months priority can be satisfied out of the corpus of the mortgaged property. And because the New Haven's current liabilities, which are mostly or completely administrative expenses prior to the mortgage lien,[22] exceed current assets, there are no assets other than corpus to satisfy such a priority. Therefore, on the facts as they now exist, no priority should be granted to any six months claimant of the New Haven.[23]

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[22]Some of the claimants have argued that no corpus invasion is necessary because six months claims are prior to certain other claims which are in turn prior to the mortgage liens. But whether the six months claims are put at the top or the bottom of the list of claims which are prior to mortgage liens is irrelevant, because proceeds from corpus available to the mortgagees will be reduced by the amount of the six months priority in either case. Where, as here, the mortgagees have recevied nothing to which the operations creditors are entitled, the mortgagees cannot be forced directly or indirectly to give up any of their security to benefit those creditors.

[23]The total claims of the petitioners asserting priority under the six months rule (with the exception of the per diem claimants) amount to $4,670,300.91.

While no issue has been raised regarding these claimants on the score of their reliance upon current revenues, rather than upon the general credit of the railroad, for payment of their bills, such a question has developed concerning those claiming pre-reorganization per diem claims. The determination of that matter and any other question concerning the qualification of per diem claimants to come within the six months rule will be deferred. At present there is no current expense fund and the rule cannot operate in favor of any claimant. Moreover, any amounts which may be due on per diem claims cannot be determined until there is a final adjudication of pending litigation and administrative proceedings concerning correct per diem rates.

The claimants have urged the righteousness of their cause with considerable fervor and have asked the court to expand the equitable doctrine to permit them to recover. Such would not be warranted. While no issue has been made in this case of the reliance for payment by the six months creditors (with the exception of the per diem claimants) on the Railroad's current earnings, rather than on its general credit, an examination by them of the Railroad's financial condition for the two years preceding the filing of the petition for reorganization would have disclosed to them that, if such a petition were filed, the chances of there being any surplus earnings were slight at best. It is more likely that reliance was in large measure placed upon the great efforts expended by management in late 1960 and early 1961 to keep the Railroad from going into bankruptcy through loans or grants by the Federal and state governments which resulted in substantial aid. Wide publicity was at that time given to these measures and assurance was given that bankruptcy had been avoided.

This is not say that the six months creditors deserve no equitable consideration at all for contributing to the continued operation of the Railroad in the public interest but they are on notice of the existing and recorded mortgages and there is no reason to stretch the equitable doctrine further. See *Kneeland* vs. *American Loan and Trust Co. of Boston,* 136 U. S. 89, 97-98 (1890). The New Haven Railroad in the interest of its creditors, its employees and the public should have petitioned in reorganization long before it did. The grave problems which have beset the reorganization would have been much less acute and infinitely more manageable if bankruptcy had not been put off until its cash was almost entirely depleted, credit was practically gone, maintenance was down and in all other respects the bottom was out of the barrel. At the very best, continued extensions of credit by operating suppliers assisted in this damaging delay and was of dubious benefit to either the public or

the mortgagees. Compare Comment, Reorganization Under Section 77, 33 Colum. L. Rev. 834, 850 (1933):

> "It is likely that the major effect of the six months rule has been to enable an inefficient or dishonest management to remain in control long after it would otherwise have been superseded. It is not unlikely that through the abolition of the six months rule railroads would be compelled to seek reorganization at an earlier date, with corresponding benefits both to security holders and to the public served."
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> * * *
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> "Its origin is shrouded in some mystery, and its present status is a subject for disagreement by the experts. Originally designed to protect the small recent creditors, it now protects the steel companies and suppliers of rail ties. It is a fruitful source of litigation in every railroad receivership and a substantial encumbrance to speedy and just reorganization."

It is highly unlikely that the financial position of the New Haven will improve. If by some miracle it should develop that non-corpus assets are available, that corpus assets exceed in value the total secured debt, or that operating revenues are diverted to the mortgages, or become sa large that there are surplus earnings, then the present claimants may, of course, renew their request for a priority.

Accordingly, the petitions seeking preferential treatment, including that of per diem claimants, are each and all denied but without prejudice to renewal upon a change of circumstances as above stated.

Dated at New Haven, Connecticut, this 28th day of August, A.D. 1967.

ROBERT P. ANDERSON
United States Circuit Judge,
sitting by designation as
United States District Judge.

APPENDIX

Year	*Operating Revenues*	*Operating Expenses*	*Taxes*	*Railway Operating Income or (Deficit)*	*Rents Net Debit*	*Net Railway Operating Income or (Deficit)*	*Income Available for Fixed Charges (Deficit)*	*Net Income or (Deficit)*
1958	$149,550,961	$125,435,142	$11,756,329	$12,359,490	$16,215,037	$(3,855,547)	$ 5,048,457	$(4,276,639)
1959	144,335,105	124,968,623	11,738,351	7,628,131	16,843,419	(9,215,288)	(1,708,132)	(10,816,003)
1960	134,044,436	121,063,593	12,174,340	806,503	17,431,834	(16,625,331)	(7,729,729)	(14,698,640)
Jan.-June								
1961	62,364,840	62,131,979	4,220,336	(3,987,475)	8,842,546	(12,830,021)	(8,014,400)	(11,777,063)
July-Dec.								
1961	64,837,655	60,324,078	4,051,505	462,072	7,209,346	(6,747,274)	(3,937,463)	(7,772,626)
Total								
1961	127,202,495	122,456,057	8,271,841	(3,525,403)	16,051,892	(19,577,295)	(11,951,863)	(19,549,689)
1962	126,176,221	115,835,382	8,767,358	1,573,481	13,087,919	(11,514,438)	(5,082,913)	(12,741,495)
1963	122,787,724	110,466,380	8,398,087	3,923,257	14,013,393	(10,090,136)	(4,883,902)	(12,264,275)
1964	121,597,371	115,204,331	9,030,688	(2,637,648)	14,418,614	(17,056,262)	(8,325,923)	(15,262,688)
1965	121,434,147	113,983,049	9,150,894	(1,699,796)	14,307,868	(16,007,664)	(8,422,450)	(15,063,389)

APPENDIX (Continued)

Depreciation Charges:	*Year*	*Depreciation Way*	*Depreciation Equipment*
	1958	$3,305,109	$5,925,337
	1959	3,342,554	5,887,828
	1960	3,220,197	6,055,176
January-June	1961	1,602,262	3,164,897
July-December	1961	1,588,268	3,155,659
Total	1961	3,190,530	6,320,556
	1962	3,227,444	6,203,679
	1963	3,038,365	6,087,287
	1964	3,021,979	5,835,731
	1965	3,026,146	5,766,671

IN THE
UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF CONNECTICUT
IN PROCEEDINGS FOR THE REORGANIZATION
OF A RAILROAD

IN THE MATTER OF
THE NEW YORK, NEW HAVEN AND
HARTFORD RAILROAD COMPANY,
Debtor.

No. 30226

ORDER CONCERNING REQUESTS FOR PREFERENTIAL TREATMENT OF UNSECURED CLAIMS.

The question of whether there exists a basis for affording prefential treatment in these proceedings to claimants who have asserted entitlement to preferential treatment as six-months creditors or on other grounds having come on for hearing on November 26, 1965 and July 18, 1966, pursuant to the preliminary order dated September 30, 1965 issued upon reading the Report of Trustees dated September 29, 1965, concerning Six-Month Creditor's Claims (other than claims on Per Diem Accounts), pursuant to the preliminary order dated October 7, 1965 issued upon reading the Report of Trustees dated October 6, 1965, concerning Pre-Reorganization Claims of Railroads on Per Diem Accounts, and pursuant to the order dated May 27, 1966 granting the Trustees' motion for a reopened hearing; and said claimants having been directed to show cause why they should not be treated *pari passu* as general unsecured creditors of the Debtor; and due notice of said hearings having been given; and all parties in interest having been heard, or given opportunity to be heard and the Court to be heard and the Court being duly advised in the premises, it is ORDERED and ADJUDGED that:

1. As of December 31, 1965, there is no basis for affording preferential treatment in these proceedings to claimants, including per diem claimants, who have asserted entitlement to preferential treatment as six-months creditors or on other grounds.

2. Each and every claimant who has asserted entitlement to preferential treatment as a six-months creditor or on other grounds, including each and every per diem claimant, is hereby severally denied preferential treatment; and this order shall be treated as though a separate order were made and entered denying preferential treatment to each claimant.

3. This denial is without prejudice to any claimant subsequently filing a timely petition with this Court for preferential treatment of his claim on the ground that circumstances occurring subsequent to December 31, 1965 have resulted in a basis in these reorganization proceedings for affording preferential treatment to creditors who have asserted entitlement thereto. Such petition to be timely must be filed at such a time in these proceedings as will not unduly delay the approval of a plan of reorganization or, in the event no plan is approved, the termination of these proceedings.

4. Until further order of this Court, the date is deferred for filing objections to the claims denied preferential treatment herein as to validity and amount and as to entitlement to classification as six-month creditors' claims in the event a petition filed pursuant to paragraph 3 of this Order is granted.

Enter:

ROBERT P. ANDERSON
United States Circuit Judge,
sitting by designation.

Dated: August 28, 1967